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Modern business lectures.

No.1,3-10, 12,13, 15-17, 19-24

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[Modern business lectures]

How Banks Serve Business

By A. Barton Hepburn

MODERN BUSINESS
LECTURE No. 16
(WITH VOLUME 16)

ALEXANDER HAMILTON INSTITUTE
NEW YORK

R.A. 31
FH 195

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By

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This Lecture, to be read in connection with Volume 16, forms part of READING ASSIGNMENT 31

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ALEXANDER HAMILTON INSTITUTE
NEW YORK

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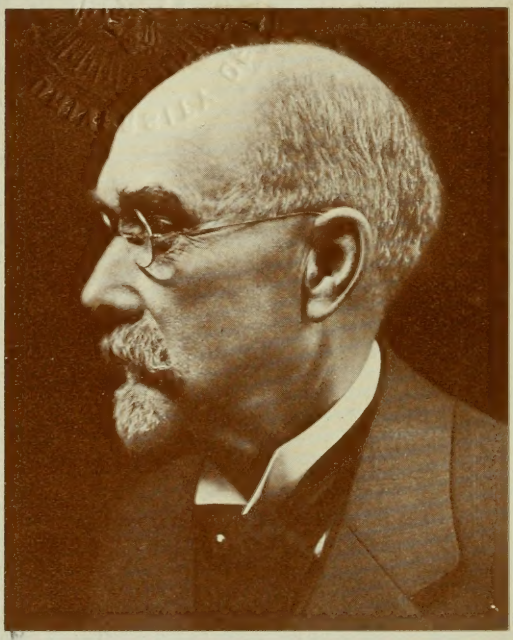

A. BARTON HEPBURN

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Born at Colton, New York, Mr. Hepburn was graduated from Middlebury College and subsequently received the degrees L.L.D. and D.C.L. at St. Lawrence, Columbia and Williams Colleges. After engaging for a time in educational work, he took up the practice of law. Later he was appointed Superintendent of Banking Department for the State of New York, United States bank examiner for New York, and later Comptroller of the Currency.

In 1892, Mr. Hepburn was made president of the Third National Bank of New York, and thereafter vice-president of the National City Bank and president of the Chase National Bank of New York. He is director of a number of prominent financial, industrial and commercial organizations, and trustee of Middlebury College and Rockefeller Foundation, member of New York Chamber of Commerce and of various scientific and literary societies.

In 1912, Mr. Hepburn received from the French Government the distinction of being made Officer of the Legion of Honor.

Mr. Hepburn is well known as an author of important works on coinage, currency and other subjects, and has contributed largely to magazines and reviews.

NOTE:—This Lecture, which is based upon the author's ripe experience in his special field, should be read in the light of the Modern Business Text, and should be studied as an authoritative message from the field of present-day business activity.

How Banks Serve Business

By

A. Barton Hepburn

I was born on a farm—a fairly good farm, judged by the standards of the neighborhood. I was one of several children, each of whom fitted into the domestic economy and performed certain activities helpful in making the family balance sheet show a credit balance. But the sun was hot and the long-drawn-out days of summer were a tax upon youthful endurance. They furnished no inspiration to youthful enthusiasm. The extreme cold of winter was perhaps even a severer trial, tho at that season the fewer hours of daylight curtailed the working day. I found myself longing for a field of activity that had a greater vista and one which with fewer intermediate hardships would take me farther in the end. I noticed that the bank did not open until ten o'clock in the morning and that it closed at the early hour of three in the afternoon. That fact appealed to me strongly. I felt that I would be willing to endure almost any amount of labor for such a limited number of hours. I promptly decided that I wanted to

become a financier and dispense credit and exercise the power incidental to such a position.

In the course of time I did become a bank president, but long before that time I had learned that a banker's activities are quite as intense as the farmer's, and that they cover just as many hours; that altho the bank does not open to the public until ten o'clock, its clerical and official force must, before that hour, have disposed of all the exchanges, the checks and drafts that represent the financial transactions of the preceding day together with those which the mail has brought in to be paid or collected, as the case may be, in the interests of the customers of the bank. I thus learned that a period of intense business activity preceded each day's opening of the bank.

I also learned with what extreme care the day's work must be conducted; that each banking day is complete within itself; that the debits and credits of the general ledger must be equal in order to prove the accuracy and correctness of the day's work; and that the difference, should any exist, must be run down, since differences carried over from one day to another would only make confusion worse confounded and would deprive the books of their value as a true record of the bank's relation with its many customers—the public. In short, I learned that accuracy as well as intensity characterizes the working mechanism of a successfully administered bank.

Many otherwise well-informed persons have only crude ideas of the service which the bank renders the community. Some think of the bank merely as a

place where money is left for safekeeping; others as a place where business men go when they wish to borrow money. Both are right as far as they go, but each has an incomplete notion of the subject. One function is inseparable from the other, and it is only in their combination that the banking function is fully exercised. The bank is engaged both in borrowing and in lending capital. It might be said to be the reservoir into which flow streams of capital that is temporarily idle and from which in turn capital is piped to the places where it is most needed for productive use.

One Form of the Bank's Service

When I think of the work which the bank performs, I am reminded of a story which was told me of a traveler in a tropical country who on arriving tired and hungry in a little village was overjoyed at the sight of the sign *Hotel.* Noting that the building looked rather unpromising, he confined his order to coffee and eggs. It was a coffee country and his drink soon appeared, but for the eggs he waited in vain. Finally he called the landlord. "But, Señor", said the latter, "I have no eggs." "Well", said the traveler, "why don't you go out and buy some?" "That I will do", was the reply, "if the Señor will advance the price."

Here evidently was a business operated without sufficient capital and without readily available banking facilities. Had the landlord borrowed a dime from a friend and bought the eggs on a promise to

repay the lender when the traveler had paid for his meal, the friend would have acted the part of a banker. The proper function of the banker is not to furnish the eggs but to provide the capital with which the eggs may be bought!

The difference between the innkeeper of the story and the ordinary man of business is one of degree rather than of kind. The business man seldom has sufficient resources of his own to make the fullest use of his opportunities. The customer, like the traveler, does not like to pay for the goods before he gets them, and even when he has got them he usually demands time in which to make payment. Ultimately, of course, the customer pays for them, but the business man cannot wait that long before dealing with other customers. Hence he calls upon the bank to help him bridge over the interval between the rendering of the service and the receipt of payment for it. Thus the bank enables its customers to work continuously, to produce more and thereby to serve the community better.

Ebb and Flow of Funds

There was a time in the early settlement of the country when banks did business merely upon the capital which the stockholders had put in and upon the notes which their charters allowed them to issue. The insufficiency of banking capital resulted in the overuse of bank currency and in a great loss to the public from the use of currency that was at a discount. With the growth and development of the

country and the increased riches of the people, these conditions changed. Instead of being only borrowers, a goodly part of the bank's customers became borrowers at certain periods of the year and depositors at other periods. The banks, receiving money on deposit from various members of their clientele, were able to loan these funds to others.

Nearly every business has a borrowing period during the year, when its capital is fully employed and must be supplemented by the use of its credit as a basis for obtaining additional funds from the bank. Similarly, nearly every business has its flush period when its notes will be retired and its bank balance will be one of considerable size. This permits the bank to equalize the demands of the community, supplying the shortage in the funds of one industry from the surplus funds of another industry, supplemented at all times by the capital and surplus of the bank.

When, for example, California sells its fruit crop and obtains the money for it, it naturally follows that the deposits in the California banks largely increase. These banks in turn increase their deposits with their New York banks or with other Eastern banking institutions who loan such funds in response to current demand. In this way the California fruit growers may be said to provide funds for the New England spinner and enable him to carry on his business.

The Banker's Advice

It is the banker's duty to study the wants of his customers so as to know in advance their probable

need for funds and to prepare to supply them. This often brings about a very close and confidential relation between banker and customer. The more the banker knows about his customer's affairs, the better will be the service he can render.

Not infrequently, the banker knows more about the business of his locality than the business men themselves know. He comes in contact with many persons engaged in various lines of business and has opportunity to learn both their strength and their weakness. The experience thus gained enables the banker to become a valuable business adviser of his community. When a man comes to the bank for a loan, he is likely to listen respectfully to whatever advice the banker may give. If the banker tells the manufacturer, for example, that his accounting system needs revision or that the installation of a better cost system is advisable, the manufacturer gives heed, for he knows that failure to follow the advice may endanger future banking accommodations. If the banker advises a dealer to institute a more vigorous collection policy, that merchant is likely to get busy. In these and similar ways the banker is a powerful aid toward better and bigger business. It is to his advantage that his customers prosper, since their advancement also benefits him.

Good Banking Policy

Banks sometimes make a mistake when they think they can do big business only thru big business. There are banks in New York City which accept no account

unless the depositor guarantees an average balance of $5,000. By taking such an attitude toward depositors, the bank limits its field of usefulness. In my judgment, the bank should accept and carry any account so long as the depositor does not overdraw. We must not forget that what is a big business today was a small business yesterday, and that similarly the small business of today may well become the big business of tomorrow. A bank which accepts deposits freely, grows with the growth of the community. The greater the number of people who can be educated in banking habits and in the use of banking facilities, the better it is both for the bank and for the community in which the bank is located.

As I have already indicated, the bank should always stand for sound business principles. At times the banker is placed in a difficult position when some one requests a loan that does not commend itself to his judgment. Of course, he may demand proper collateral and thereby protect the bank in case the borrower's project meets with disaster, but to do this is not, in my opinion, enough. The greatest kindness to the borrower under such circumstances is to refuse the request altogether. The bank may for the time being lose money by so doing, but in the long run it establishes a reputation for prudence which bears fruit in a larger business, profitable alike to the bank and to its customers.

The Source of Banks' Funds

Since the establishment of the National banking system, which came into existence during the period of our Civil War, bank currency has not really added anything to the banking power of any institution. The reason for this is that banks were required to buy government bonds as a basis of bank-note circulation, paying at times a high premium for such bonds. Since, therefore, they were not allowed to take out note circulation in an amount equal to the price of the bonds, their banking power really was limited thereby and not enlarged.

It followed naturally that the banking power—that is, a bank's power to furnish funds to its customers—was dependent upon its capital and surplus, and upon the deposits of its customers. A statement of the National banking system (November 20, 1917) shows capital, surplus and undivided profits of $2,236,000,000 and deposits of $14,798,000,000. This shows the banking power of the National banking system to be the enormous total of $17,034,000,000. Mathematical computation shows that only a little more than 13 per cent of this total sum belongs to the stockholders of the banks, the remaining 87 per cent belonging to depositors. In other words, present-day banking is conducted mainly upon depositors' money, the stockholders furnishing merely enough in the form of capital and surplus to margin the business and command public confidence.

My youthful estimate of the autocratic power of a bank president received a shock when I learned that every person who kept an account with a bank had a banking equity—in other words that he had a right to call upon the bank for loans and discounts in proportion to the size of his bank balance and the character of the account he had kept, his credit claims being proportionate to the value of his account to the bank. In difficult times a bank manager instead of autocratically dispensing credit in accordance with his own judgment or caprice, as some may think, is put to the severest tests and subjected to the greatest labor and anxiety in his effort to keep the funds of his institution in a sufficiently liquid state to enable him to respond to the legitimate demands of his customers and supply them with the funds they have a right to demand for the proper conduct of their business. It is in a time of stress—money stringency—that business needs bank credit and must have it in order to maintain its own credit and avoid disaster. The real test of ability on the part of bank officers is to keep their institution in a position where they can meet this normal and legitimate demand for funds.

It will be seen, then, that the bank president, instead of being an autocrat in the domain of business, is really a servant of business men. It will also be seen that banking, instead of being a leisurely employment, as the uninformed often believe, is fre-

quently—and especially in times when credit is disturbed and business generally disorganized—one of the most strenuous of employments. A banker may have everybody's money; but in troublous times he also has everybody's troubles.

Confidential Relations

The essence of wise banking—the underlying motive actuating every successful bank management, is to try and make money *along with,* instead of *out of,* the customer. The relation should be one of cooperation. In a moral sense, the bank management and the business which comes to the institution are closely identified, and the banker necessarily becomes the custodian of many secrets with regard to his clientele. Credit statements are required, resources and liabilities are carefully looked into and the efficiency and competency of the management is carefully scrutinized.

This is especially true in times of trouble. But the good banker keeps his knowledge of the private affairs of his customers securely and firmly locked in his own breast and never mentions them in public.

Some years ago I was called upon with two others to take charge of the affairs of a moribund financial institution and rescue whatever could be saved of its assets. In the course of this work I found one young man in the employ of the defunct company who evidently understood thoroly the business of the concern. Tho he occupied only a subordinate position, he was able to afford me more aid in unraveling the

tangled skein of the business than the president himself could give me. In the course of our work I grew to have a very high regard for this young man's ability, judgment and character. When after two or three years of liquidation the affairs of the company were straightened out, this young man told me that he wanted to go into the bond business. His resources were small, but I felt confidence in his honesty and integrity, and the bank made it possible for him to carry out his resolution. Arrangements were made whereby he was enabled to purchase small issues of bonds which he sold again to his customers. Little by little his business grew, and his concern gradually acquired a high standing in investment circles and did a large business. The aid given him by the bank at the outset of his business career was not forgotten by him. His account remained with the bank and in time became one of its important assets.

Discriminating Judgment

The banker, by virtue of his position, has great power, but with this power he has great responsibilities, not only of a financial nature but also of a moral one. A good banker must be a good man, and a good banker can be helpful in many unobtrusive ways to the people who do business with him. Character is the foundation of confidence and is the principal and first element to be considered by a banker, both in deciding whether he will take the new account that is offered him and in determining his treatment of the account after he has received it.

An experience covering a generation would enable me to give countless instances of businesses, both individual and corporate, that began in a very modest way with balances not sufficient even to pay the expense of the bookkeeping, but that in the course of years grew to very large proportions and became among the best and strongest of the bank's accounts. This is precisely what good banking management aims to do—build up its business by proper discrimination as to the character of the accounts and the men behind them, and by helping these men to succeed. In no other way can a banker bind business to him so closely; in no other way can he make friends so loyal and constant. By no other means can he so successfully promote the growth of his own institution; for business, like love, begets its kind. It is with the banker as with everyone else: he who wishes to succeed should deserve to succeed; and invariably the best way to help oneself is to help others.

Bookkeeping Instead of Money

The banks in large cities combine in clearing-house organizations and effect their collections largely as a matter of bookkeeping, thereby simplifying not only their own work but also that of their customers. Each day the bank takes to the clearing-house all the items it has for payment by other banks and receives credit for them. The other banks in turn bring to the clearing-house whatever items they have against this particular bank. The difference, whether debit or credit, represents the balance this bank will pay to

or receive from the other banks, and this balance is received or paid in money. The debits are paid to the clearing-house in money, and the clearing-house in turn divides up this money between the creditor banks. Of course, the debits and credits are always equal. To illustrate: the average daily exchanges to the New York clearing-house in 1917 were $601,000,000, yet the average daily balances which were paid in cash amounted to only $40,000,000. It thus appears that by the mechanism of clearing by bookkeeping, $40,000,000 in currency was made to do the work of a sum fifteen times as large.

But each bank is also a clearing-house to its own clientele. In the case of two persons, each of whom maintains an account at the same bank, A pays his indebtedness to B by check. B deposits the check with his bank. The bank merely debits A with the amount and credits B. No money has passed, yet the payment is complete. Over 90 per cent of the business transactions of the country are settled in this way—that is, by means of checks and drafts without currency in any form appearing in the transactions.

When Money Is Needed

The fact that so large a percentage of business is done by checks and drafts explains the difficulties in times of money stringency or panic, which have occurred in the past. People becoming distrustful, hesitate to accept checks and insist upon being paid in currency. That creates an undue demand upon the currency of the country, and a resultant strin-

gency follows. Under the hide-bound provisions of the National Banking Act, the banks were compelled to invest more money in bonds as a basis for note circulation than the face value of such circulation, hence the banks were powerless to protect themselves against the money stringency. For it should be remembered that in times of financial stringency and panic the demand is not for credit but for money. Thus, in 1893, the nation went thru a severe monetary disturbance. The policy of the Government with respect to the coinage of silver dollars had given the country much concern, and trouble on this account was expected. The failure of the Baring Brothers of London, in that year, precipitated the crisis. But it is interesting to note that while there had been a surplus of silver dollars, and while this in fact was the underlying cause of the crisis, when the crisis came, these despised silver dollars were legal means of payment; they commanded a premium of 3½ per cent.

A Remedial Measure

Difficulties of this sort have been largely overcome, however, by the Federal Reserve Bank Act, which provides for the issue of bank notes against commercial assets and thereby affords the relief to which the business interests of the country are entitled and which the banking systems of other commercial nations have long since provided. The business community ought not in the future to suffer from a currency deficiency, since the Federal Reserve Act makes

provision for ample circulation at all times. It is another instance of the bank's ability to serve the business community.

The Federal Reserve Act marks a great step forward and will be of untold benefit to the commercial and material interests of the country. Already it has done much toward making the banks of the country a system rather than an aggregation of uncoordinated units. Even in former days, however, banks often stood together in times of stress, and thru cooperative action averted impending disaster; but the fact that such measures as clearing-house certificates and the concerted refusal (as in 1907) to pay deposits in cash, were merely the fruits of emergency, and sometimes even of doubtful legality, limited their effectiveness. The new law, on the contrary, has distinctly legalized in advance definite emergency measures, and a resort to them will not shake public confidence. Thru the rediscounting provision it has given to the individual bank the power to protect itself in any sudden emergency which may threaten it.

Of course it must not be overlooked that the success of the Federal Reserve System will, in the long run, depend upon the ability of the banks to avail themselves of the rediscounting privilege. Only certain of its loans can be used for this purpose. It is the duty of every bank to induce its customers as far as possible to make use of the types of commercial paper to which the rediscount privilege applies. Only thru considerable changes in commercial usage can

the safeguards which the law throws around the banking system reach their full effectiveness. Rome was not built in a day and a banking system cannot be revised overnight. But the lines are set for development in the right direction.

While many of the results desired by the framers of this law will doubtless be realized, some of them seem doomed to failure. The law was passed largely in the hope of decentralizing money by taking it out of New York and the larger money centers and distributing it thruout the country where the twelve Federal Reserve Banks are located. This attempt has been measurably successful; nevertheless, economic laws will assert themselves, and concentration of funds in metropolitan centers, especially in the form of bank deposits, has become even greater since this law was passed than it was before.

Legislative Regulation

Many feared that the banking reform planned would be hampered by a minute legislative regulation of details. A centralized system of banking requires less definite supervision by the government than do a great number of small independent banks such as we have in the United States. When the function of banking is in so many hands, more reliance must be placed upon government supervision than upon banking insight for the safety of the system. It would have been a grievous error to clog the new system with legislative restrictions. What was needed was greater freedom and a reliance upon principles rather

than upon rules to guide it. Probably the greatest service rendered by the bankers who were consulted in the framing of this law, was their criticism of its unwise and rigid provisions, which would have rendered the operation of the law impracticable. Congress recognized the justness of these criticisms and eliminated the rigid provisions, reposing the power contemplated in the Federal Reserve Board. That was unquestionably a wise course. It tended to make this system more the equivalent of a central bank. The commercial and financial history of the world has demonstrated that a central bank is the most effective instrumentality for protecting the currency and credit of a country.

Undoubtedly, as time goes on, there will be a growing refinement of our banking system and with it an increased ability of banks to serve business.

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